

**Final Statement of Reasons for
Adoption of Proposed Amendments to California Code of Regulations,
Title 18, Section 1684, *Collection of Use Tax by Retailers***

Update of Information in the Initial Statement of Reasons

The factual basis, specific purpose, and necessity for, and the anticipated benefits from, the proposed amendments to California Code of Regulations, title 18, section (Regulation) 1684, *Collection of Use Tax by Retailers*, are the same as provided in the initial statement of reasons.

The adoption of the proposed amendments to Regulation 1684 was not mandated by federal law or regulations and there is no federal regulation that is identical to Regulation 1684.

The State Board of Equalization (Board) did not rely on any data or any technical, theoretical, or empirical study, report, or similar document in proposing or adopting the amendments to Regulation 1684 that was not identified in the initial statement of reasons, or which was otherwise not identified or made available for public review prior to the close of the public comment period.

In addition, the factual basis has not changed for the Board's initial determination that the proposed regulatory action will not have a significant adverse economic impact on business and the Board's economic impact analysis, which determined that the Board's proposed regulatory action:

- Will neither create nor eliminate jobs in the State of California;
- Nor result in the elimination of existing businesses;
- Nor create or expand business in the State of California; and
- Will not affect the health and welfare of California residents, worker safety, or the state's environment.

The proposed amendments may affect small business.

Notice of Correction

The Statement of Specific Purpose and Necessity in the initial statement of reasons correctly provides that the "Board considered Formal Issue Paper 12-003 during its February 28, 2012, Business Taxes Committee meeting, and the Board voted to propose the adoption of staff's recommended amendments" to Regulation 1684 at that time. However, the Informative Digest/Policy Statement Overview provided in the notice of proposed regulatory action published in the April 6, 2012, edition of the California Regulatory Notice Register (Register 2012, No. 14-Z, Page 456) contains the following paragraph, which incorrectly indicates that the Board considered the issue paper and voted to propose the amendments to Regulation 1684 during a Business Taxes Committee meeting on February 28, 2011, instead of February 28, 2012:

During its February 28, 2011, Business Taxes Committee meeting, the Board determined that staff's recommended amendments are reasonably necessary to accomplish the objectives of making Regulation 1684 consistent with the amendments made to RTC section 6203 by AB 155, implementing and clarifying the new provisions that were added to section 6203 regarding "substantial nexus," "commonly controlled group nexus," and "affiliate nexus," and providing notice to retailers that they will be required to register to collect California use tax if they have a "substantial nexus" with California once the amendments made to section 6203 by AB 155 become operative. (The interested parties process and February 28, 2011, meeting are discussed in more detail in the initial statement of reasons.)

The Board posted a notice of correction regarding the typographical errors in the notice of proposed regulatory action on its website on May 29, 2012, and Board staff noted the errors and correct date during the public hearing on May 30, 2012.

No Mandate on Local Agencies or School Districts

The Board has determined that the adoption of the proposed amendments to Regulation 1684 does not impose a mandate on local agencies or school districts.

Public Comments

The Board received written comments regarding the proposed amendments to Regulation 1684 from Mr. Albin C. Koch, via a letter dated May 29, 2012. In his written comments, Mr. Koch recommended that the Board "consider expanding the rebuttable presumption in proposed Regulation 1684 (b) to recognize that all, or at least most, large remote retailers selling to California purchasers via the internet, catalogs, or telephonically do so via 'sales on approval' under which, in accordance with present regulation 1628 (b) (3) (D), they continue to own the goods being sold until after their delivery to and acceptance by California purchasers. Thus, at least such large remote retailers should be considered to have substantial physical presence and 'substantial nexus' within the state of California and therefore be liable to collect and remit use tax from their purchasers in accordance with RTC § 6203, as amended by AB 155." Mr. Koch also recommended that the Board add the following sentence to the end of proposed Regulation 1684, subdivision (b)(3):

A retailer will be regarded as having a physical presence in California if it makes substantial sales to California purchasers that constitute "sales on approval" within the meaning of existing Regulation 1628 (b)(3)(C).

Mr. Koch subsequently appeared at the public hearing regarding the adoption of the proposed amendments to Regulation 1684 on May 30, 2012. Mr. Koch expressed his full support for the Board's proposed amendments, and the (above) sentence Mr. Koch recommended adding to the regulation. He also explained that a remote seller making a sale on approval to a California customer still owns the property at the time it is delivered

in California, and that, in his opinion, this could create substantial nexus for a large retailer.

Commercial Code section 2326 defines the term sale on approval narrowly and explains that the delivery of goods to a consumer is a sale on approval only if the consumer has the right to return the goods, even if they conform to the contract. Further, the California Court of Appeal has held that “the general presumption runs against a delivery to a consumer as being a sale on approval” and that the fact that an industry accepts returns does not convert “ordinary retail sales contracts into ‘sales on approval.’” (*Wilson v. Brawn of California, Inc.* (2005) 132 Cal.App.4th 549, 558.) Instead, the Court of Appeal has held that section 2326 only “addresses transactions where the parties intend the goods in question to continue to be the seller's property after the buyer takes possession of them . . .” and the purpose of a sale on approval is to give the buyer the ability to “use the goods” and the “option to purchase” the goods after a reasonable period of time. (*Ibid.*)

During the May 30, 2012, public hearing, Board staff expressed its opinion that it is not necessary for the Board to specifically address sales on approval in Regulation 1684 because the Board’s Legal Department does not believe that out-of-state retailers are making significant amounts of sales on approval to California customers due to the nature of such sales. Board staff expressed its opinion that the sentence Mr. Koch recommended adding to Regulation 1684 might create confusion, rather than clarify the regulation or aid in the Board’s administration of the proposed amendments, because:

- The Board’s Legal Department does not agree that an out-of-state retailer that makes a sale on approval to a California customer necessarily has a substantial nexus with California; and
- Adding the suggested sentence to Regulation 1684 would create the inference that retailers making sales on approval to California customers have a substantial nexus with California and are therefore required to register to collect California use tax.

Board staff also explained that the rebuttable presumption being added to Regulation 1684, subdivision (b)(2) applies to all retailers with a physical presence in California and the Board can determine whether a retailer that is actually making sales on approval to California customers has a physical presence in and/or a substantial nexus with California if and when the issue is actually raised.

In addition, Mr. Fran Mancina appeared at the May 30, 2012, public hearing on behalf of MuniServices, LLC, and expressed support for the adoption of the Board’s proposed amendments to Regulation 1684 and the collaborative interested parties process that produced the proposed amendments.

At the conclusion of the May 30, 2012, public hearing, the Board unanimously voted to adopt the proposed amendments to Regulation 1684 without any changes. No other

interested parties submitted written comments regarding the proposed amendments to Regulation 1684 and no other interested parties asked to speak at the public hearing.

Determinations Regarding Alternatives

By its motion, the Board determined that no alternative to the proposed amendments to Regulation 1684 would be more effective in carrying out the purposes for which the regulation is proposed, would be as effective and less burdensome to affected private persons than the adopted regulation, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provisions of law.

Furthermore, the Board did not reject any reasonable alternatives to the proposed amendments to Regulation 1684 that would lessen any adverse impact the proposed amendments may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed amendments. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action. Although Mr. Koch did recommend amendments to Regulation 1684, his amendments were additions to the Board's proposed amendments, not alternatives, and Mr. Koch did not present any evidence to indicate that his recommended amendments would lessen the adverse economic impact of the Board's proposed amendments on small businesses or that his recommended amendments would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

In addition, the Board's proposed amendments are anticipated to provide the following benefits:

1. Ensure that Regulation 1684 is consistent with the provisions of new section 6203 (as added by § 3 of Assem. Bill No. 155 (Stats. 2011, ch. 313)), when new section 6203 becomes operative;
2. Give needed guidance to retailers as to whether their activities create a "substantial nexus" with California and will require them to register with the Board to collect use tax when new section 6203 becomes operative;
3. Ensure that new section 6203 is interpreted and administered consistently with United States Supreme Court and California court opinions regarding substantial nexus, including, but not limited to, *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, *Quill Corporation v. North*

Dakota (1992) 504 U.S. 298, *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue* (1987) 482 U.S. 232, *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, *National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, *Current, Inc. v. State Board of Equalization* (1994) 24 Cal.App.4th 382, and *Borders Online, LLC. v. State Board of Equalization* (2005) 129 Cal.App.4th 1179; and

4. Ensure that new section 6203's affiliate nexus provisions will be interpreted and administered consistently.